



MATTHEW SZULIK
CALLS OPEN-SOURCE
SOFTWARE A "25- TO
50-YEAR OPPORTUNITY."

1^{the} long view

Red Hat CEO

BY JOHN R. QUAIN

Matthew Szulik is determined to make open-source software the driving force of the digital revolution.

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EVAN KAFKA



Regarding growth horizons, Matthew Szulik, the chairman, president and CEO of RED HAT INC. (RHT), says that he takes a long view — a very long view. “This is not a 90-day opportunity,” he insists, “it’s a 25- to 50-year opportunity.” Specifically, Szulik says his goal is to turn what many in the computer industry considered an impractical, idealistic grassroots movement into a thriving business and a driving force behind the digital revolution. ¶ Red Hat’s business is based on open source — the free software movement that started with the Linux operating system. The challenge, Szulik admits: There’s no proprietary intellectual property to sell. Open-source software development means that anyone who agrees to the terms of a license can have access to the software

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and its building blocks, so different programmers and companies contribute to its development, he explains. No one company can fully own an open-source product, he acknowledges.

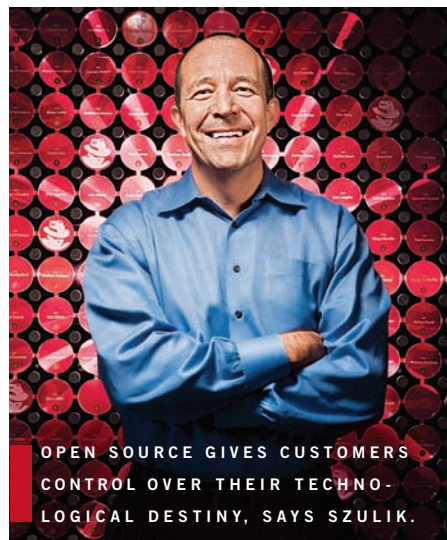
“But open-source software is not *free* software,” emphasizes Charlie Peters, executive vice president and CFO. Customers, he explains, can download copies of the company’s Fedora Linux without charge, but they pay for enhancements to make the software work efficiently with other applications and to receive technical support and updates. Red Hat, says Peters, derives 70 percent to 75 percent of its revenue from selling subscriptions for service and the balance from consulting, support and maintenance services. According to independent industry analysts, the Raleigh, N.C.-based Red Hat, with 2006 sales of \$278.3 million, accounted for 61 percent of all commercial shipments of the Linux operating system worldwide last year, with its nearest competitors — Novell Inc. and Xandros Inc. — combined reporting less than half its revenues.

GROWTH MODEL

Fourth-quarter sales of \$105.8 million represent a 45 percent increase over the same quarter the previous year, says Peters. He says most of the gain comes from higher subscription sales, including those for Red Hat Enterprise Linux. Late last year, reporting more than 1,700 workers in 50-plus offices globally, the company transferred to the New York Stock Exchange.

Szulik predicts that the market will continue to grow for decades to come as more businesses adopt Linux software and develop content based on the open-source model, and as the trend

expands into mobile devices such as smartphones. Indeed, several leading computer companies, including **HEWLETT-PACKARD CO.** (HPQ) and **IBM CORP.** (IBM), recently joined forces to support the Linux Foundation, an organization that promotes the open-source model of software development — the kind of endorsement that Red Hat says will only bolster its business.



Red Hat was founded in 1993 by Marc Ewing, a programmer who had made improvements to the then-new Linux operating system, and Robert Young, who had a background in technology marketing. In 1998, Bill Kaiser, a Red Hat board member and partner at the venture-capital firm Greylock Partners, an early investor in the company, threw Szulik’s name into the ring for president.

Kaiser had met Szulik in 1989 while recruiting for MapInfo Corp., a startup he helped fund. Szulik did join MapInfo as vice

president of sales and marketing, but Kaiser says he lost touch with Szulik until catching up with the executive again when Red Hat was searching for a new head. By 1998, Szulik had moved to North Carolina, where he was president of the enterprise-software developer Relativity Software.

OPEN-SOURCE BELIEVER

Kaiser explains that it was essential that the new president (Szulik gained the CEO spot shortly after the company’s 1999 IPO) understand Red Hat’s commitment to open-source software. The people responsible for some of the greatest technical innovations in open-source software are often more interested in promoting social progress and improving people’s lives than in meeting business goals, he says. “Some might have been tempted to turn Red Hat’s software into a closed, proprietary system,” says Kaiser. “That would have been a grievous error.” Instead of being just another “empty suit,” he allows, “Matthew connected with the open-source people at a personal level and built their trust through his actions.”

A husband and father of three children, ages 12, 18 and 20, Szulik, now 50, grew up in New Bedford, Mass., just west of the more affluent Cape Cod. He attended Saint Anselm College in Manchester, N.H., on a golf scholarship, earning a bachelor’s degree in natural science in 1978. Then Szulik moved to the Boston area as a Unix product manager at Exxon Office Systems Co. During that time, Szulik attended lectures about the free-software

movement, which he describes as “the ethical idea that all should be free to share and change the software they use.”

SOFTWARE FREEDOM

Szulik checks off several benefits of Linux in general and Red Hat’s software in particular. Compared with Microsoft Corp’s Windows or Apple Inc.’s OS X, Linux is more secure, he notes, because open-source software comes in more variations (thus making it more difficult for hackers to target). Moreover, customers are free to adapt the software to their own needs without infringing on copyrights. In short, he contends, the Linux platform gives customers control over their technological destiny.

Red Hat’s products also provide a less expensive model for businesses — which can use as many copies as needed for one price — and for Red Hat, says Peters. “People all over the globe work on the software,” explains the CFO, “but we don’t have to pay them. Only 15 percent or so of all the contributions to the Linux kernel [or core software] come from our engineers.” Still, Red Hat reports that it spent \$41 million in R&D in 2006, or 15 percent of revenues, a 26 percent increase over the previous fiscal year.

Of course, the open model also means that competing Linux versions are available at no charge. Analyst Todd Weller* at Stifel, Nicolaus & Co. Inc., a subsidiary of **STIFEL FINANCIAL CORP.** (SF), worries about a wave of new competition. He cites Oracle Corp.’s October announcement that it would sell Linux maintenance services for less than what Red Hat charges, and Microsoft Corp.’s recent statement that it would support Novell Inc.’s competing version of Linux. But Peters contends that the attention of industry stalwarts actually vindicates Red Hat’s view of the viability of open-source software.

Competition means that Red Hat has to deliver “persistent value,” says Szulik. “If we don’t add value,” he says, “you should get rid of us.” The CEO says that by increasing offerings and support for other systems and applications, Red Hat continues to add value for customers.



“In the past 12 months,” notes CFO Peters, “we have re-signed 98 of the 100 largest subscription deals up for renewal.” The company notes that *CIO Insight’s* vendor-value survey has ranked Red Hat among the top three software companies for three years in a row.

Although current customers range from the U.S. Department of Defense to **DREAMWORKS ANIMATION SKG INC.** (DWA), which uses Linux to build its movies, says Szulik, an early adopter was the financial-services industry. The CEO recalls his stint between 1981 and 1989 at Interleaf Inc., a content-management software firm whose products ran on Sun Microsystems Inc. platforms. “I watched Sun introduce its workstation in 1983,” he says. According to Szulik, Sun got Wall Street firms to embrace its products, which opened up other markets.

“It was no accident that when we brought out Red Hat Enterprise Linux in 2003 that we went to Wall Street first,” points out Peters. “Now, almost every Wall Street investment bank runs on Red Hat Enterprise Linux,” according to Peters. “And from those early customers, it spread to 70 percent of the Fortune 500, and for the last five quarters, we’ve been adding about 10,000 new customers every quarter.”

That rate of customer acquisition, suggests Szulik, is due to Red Hat’s focus on server and workstation business installations

rather than consumer desktops. He says businesses are more likely to switch to Red Hat than individual consumers, since savings on operating thousands of computer systems would be more apparent.

To broaden its appeal to business customers, Red Hat indicates, last year it spent \$420 million for privately held JBoss Inc., which makes the middleware that is used to help operating systems such as Red Hat Linux work with a wide variety of otherwise incompatible software applications. Red Hat reports that it is looking for additional open-source tools to further its growth. “We’ve got \$1.1 billion on hand in cash and investments,” notes Peters.

EQUANIMITY + PASSION

Describing himself as an avid Boston Red Sox fan, Szulik says that he enjoys discussing technical details with Red Hat engineers. Colleagues add that he’s also a passionate evangelist for open-source software development. “When he gives a speech, he never uses notes and can talk for an hour, and people are just captivated by his words,” says Peters, who describes Szulik as a “great communicator.”

Adds Kaiser: “Matthew may appear to be a man of great equanimity, but he’s also a man of deep passion. He cares very deeply about things that are important to him.”

FAMILY VALUES

Szulik says that what is most important to him is his family. "We're one of those old European families that feels a strong responsibility to one another," explains Szulik, referring to his Polish heritage. For example, Szulik, whose now 94-year-old father came to live with him a few years ago, says he enjoys hearing his father tell the grandchildren stories about the Great Depression. Meanwhile, Szulik indicates that his in-laws live just two miles away. "Our business is headquartered on the campus at North Carolina State University," he explains. "My dad graduated from NC State, and my wife's father was a dean there."

Despite such an appreciation for his home life, Szulik is famous among his colleagues for his global perspective. According to Kaiser: "Red Hat does nothing without considering international aspects." Indeed, the company indicates that its global ambitions were a primary motive for transferring its listing to the NYSE. "As we look at the future, we think that Red Hat and the NYSE are on common paths to provide global exposure," says Szulik. With "almost 50 percent of our sales coming from outside the U.S.," he explains, "we're just beginning to penetrate markets such as China, Russia, Brazil and Argentina." These nations see

open-source programs not just as cheap software, he says, but also as a way to transform their economies.

Many global corporations and governments outside the U.S. already use Linux to support digital infrastructures, says Szulik, who notes that Vienna, Austria, is rolling out Red Hat software across its municipal systems. Szulik says that Red Hat often enjoys an advantage because many foreign governments aren't already locked into proprietary software investments.

OPPORTUNITIES

Szulik says that he expects many more opportunities for open-source software in the continuing global telecommunications expansion. He points to everything from smart mobile phones to TV and video programs delivered over the Internet as growth areas for the company.

Red Hat reports that it has joined efforts such as the European Community Open Platform for User-Centric Service Creation and Execution, which aims to promote an open-source telecom infrastructure that would support conventional phone systems, digital voice over IP services and Internet television. Indeed, Szulik suggests that open-source software may be the key to creating bundled services that include phone, Internet and television delivery. Signs indicate that major telecom

companies agree: **NOKIA CORP.** (NOK), for example, recently signed to use Red Hat in its critical communications switches, says Szulik.

Red Hat is also exploring the online social-networking phenomenon. "We started to think of ways to create a great user experience" in an online collaboration space, Szulik explains. The result was Red Hat's Mugshot (mugshot.org), which is a flexible, information-sharing site reminiscent of a business-oriented version of MySpace. "It's still immature," the CEO admits, and won't be officially released until sometime later this year. But he says he's encouraged by the potential for such online tools. "We got a call the other day from a university dean who wanted to use Mugshot as a method for teaching and delivering content to his students," Szulik says. "I don't think that all these social-networking sites out there have even scratched the surface of what the potential might be."

Szulik says he sees opportunities stretching far into Red Hat's future. "In five or 10 years, we believe a great percentage of the world will be creators of content, which will provide exciting economic models," he says. "That puts us in an enviable position to compete for the future." □

*Todd Weller at Stifel, Nicolaus & Co. Inc. is not an officer, director or member of an advisory board at Red Hat Inc., nor does he or his company own positions in Red Hat.

doing the right thing

"THERE'S A VERY STRONG ETHOS within the open-source community of doing the right thing," says Matthew Szulik, Red Hat CEO. "The culture of the company demanded that we do this," he adds, referring to Red Hat's participation in the One Laptop Per Child project initiated by Nicholas Negroponte, an MIT professor who is chairman of the nonprofit association. Of course, Szulik indicates that he and others also hope the project will spawn a whole ecosystem of related open-source products to help promote education and development in less-developed countries.

The project, explains Szulik, hopes to deliver later this year its first low-cost, \$100 computers to children in underdeveloped regions of countries such as Brazil, Nigeria, Libya, Thailand and Uruguay. Dubbed XO machines, the laptops feature high-tech accoutrements, including built-in cameras, wind-up batteries

and built-in wireless communications, he says. Designed specifically for children who may never have seen a computer before, he adds that the machine uses a slimmed-down version of Linux, in part to lower its overall costs.

Szulik says the project's lead software integrator was Red Hat's own Christopher Blizzard, systems engineer, who compiled 90 percent of the basic software from existing open-source software. Yet the software is flexible enough to handle word processing and a Web browser that receives automatic news feeds, says the CEO. Unlike traditional folder-based software programs, it focuses on task-oriented journals that Blizzard and others hope will be easier for children to use, he adds. To get the XO in the hands of children, Szulik explains, donors and governments will purchase the machines. He notes that Red Hat is donating its participation.